Is Sudden News an Origin of More Systematic Risk in Common Stocks?

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Abstract

The existence of political risk is so common in the equity markets of the world and specifically for Pakistan. The business owners are always with their extravagant concerns in this connection while formulating business strategies and policies for their desired returns. The purpose of this research is to examine whether or not sudden news poses a more systematic risk in equity market. The findings suggest that the investors of all kinds take more risk and follow the similar patterns to invest in equity market when there is the sudden news. On the other hand, if there is no sudden news, then there is a different investment pattern of investors in equity market along with the lesser magnitude of taking risks.

Keywords: Equity market, Systematic Risk, Beta, Sudden news.

1. Introduction

Most of the financial researches are concerned with the effect of managerial decisions on the market value of the firm. Thus, the effect of changes in capital structure, dividend policy and investment strategy on profitability of firm and risk has been broadly investigated on both the conceptual and empirical levels.

The purpose of this study is to examine and interrogate the origin of systematic risk in common stock in connection with commence of sudden news for the Pakistani space.

2. Literature Review

It is widely accepted that systematic risk is not fixed and it has various fluctuating trends, which are so

to speak as moments, shocks and volatilities. Systematic risk or Beta is a nonlinear function of a random market weight and market return process (Goldenberg, 1985).

The social movement in a business is backed by the individuals' behavior about buying and selling price in the market. This leads to the financial incentives and efficient markets as studied in the macroeconomics literature (Shiller, Fischer, & Friedman,1984). When we talk about buying and selling of money then it's all about stocks and the share price. Share price is taken as a low price as there is no definite predictor of investment growth and no accepted rationale about the value of stock. Ordinary investors do not have a model, or at the best price, the dividend yield or speculative asset of the evolution of a comprehensive model. The financial impact of the decision-making styles, a sudden change in the volatility of returns to investors or not may lead to a major occurrence. The organizations should center their decisions on the identity management risk of stability and change (Malik, Ewing, & Payne, 2005).

Noise traders play an evident role in the buy and sell stock market and investors have different rational prospects. For example, if the noise traders believe that the rebound in stock prices can continue, rational traders can take advantage of this through the purchase of an upward trend as the trend gets worse. This positive feedback trading strategies and other technical trading strategies can be considered reasonable. Noise traders expect to fully understand the rational players and some uncertain means like absurd noise class (Brian, John, Blake, Richard, & Paul, 1996).

The volatility of the return of the market index is to measure the amount of alternative estimate of the two including an estimation and robust index of refraction low and high every day. An evidence of a reversal in the market after the jump does not have a positive or negative effect on the market index return shortly (Turner & Weigel, 1992).

The economic and financial crisis is termed as systematic risk. Quantitative literature of systemic risk has increased significantly over the past two years although the general theoretical model is still missing. There has been less exchange of empirical research on systemic risk and safety system (Bandt & Hartmann, 2000).

The impact of overall economic performance of large manufacturing companies, strategic planning and risk is measured by examining the rate of return to shareholders if any news does not affect the index market (Kudla, 1980). Financial information, past price and suggested strategies should be used to predict the beta, which shows a statistically correct procedure of sudden news sources of information. Also, estimate the end of the production forecast based on historical performance of the index beta = 1 (Aggarwal , 2006).

The security firms break the fund's portfolio according to market beta into two components, including the market condition of the companies and any news about future benefits or drawbacks, which reflects the index market. Empirically, investors find that index betas are significantly higher due to any negative news or vice versa, which may explain the average risks of their investments (Campbell & Vuolteenaho, 2004). It depends on company's prospects and their actions that can alter views and magnetize investors. For example, good news and bad news dependent on the noise generator/ process or the production of new information just cannot expect price changes on a continuous series (Fama, 1965). Turnover and price volatility in real markets is high, than the standard theory predicts and show an autocorrelation. Equity income is also small but with significant set of correlations (Brian, John, Blake, Richard, & Paul, 1996).

It is believed that the market closes almost any event and leads to irrational investors to sell. It is found that in this situation the investors focus is on eliminating unnecessary bubble factors. Hence, this will cause public confidence tumbling and prices plummeting (White, 1990).

Economists believe that market mechanisms can be used as an alternative choice in order to summarize the information that predicts the election results, which can affect the whole market index (Bohm & Sonnegard, 1999).

Mankiw and Shapiro (1986) founds that nowadays the impact of strategic planning, research and statistical analysis shows no significant difference between the return earned by shareholders of the

company due to the volatility of the index market. Likelihood, that few people find their own mistakes and begin to develop more intelligent (or at least different) expectations.

This can change the market, which means that all smart players may have to adjust their expectations. Due to changes in rational players' act, the market will change again and so forth, noise traders can continue to change. Force makes sense to market transactions adapt to merchants. True noise in theory will begin to dissolve and fully rational traders will easily guess another to change and monitor market expectations (Brian, John, Blake, Richard, & Paul, 1996).

3. Proposition and Hypotheses

P: The sudden news is the origin of more systematic risk in common stock.
H1: KSE index with sudden news has greater systematic risk.
H2: KSE index with no sudden news has greater systematic risk.

Where,
Fluctuations in systematic risk = SD of beta from its mean

4. Research Methods

4.1 Method of Data Collection and Econometrics applied

In order to interrogate the proposition of the paper the beta (systematic risk) and the difference between the high closing price and low closing price which is so to speak as the point change have been sampled on daily basis from January 2007 to November 2011. The daily observations of the outlined variables have been recorded for 1400 days from the various sources which include Kse.com.pk, Scs.trade.com, Moosani.com, Apnakse.com and Zhvsec.com for the equity market of Pakistan i.e. Karachi stock exchange. For evaluating the considered data and assessing the stated proposition the analysis of moment has been deployed.

5. Findings and Results

The findings of this paper reveal as shown in table 1 that the systematic risk (beta) and the difference between the high closing price and low closing price (point change) at equity market (KSE 100 index) are more when there is no sudden news in the market (i.e. Mean of beta & point change when no sudden news > Mean of beta & point change when sudden news) hence we fail to reject the first hypothesis i.e. KSE index with no sudden news has more systematic risk while the second hypothesis got rejected as highlighted in table 2.

The findings also suggest that the systematic risk (beta) and the difference between the high closing price and low closing price (point change) at equity market (KSE 100 index) are also scattered more when there is no sudden news in the market in comparison of the presence of sudden news as SD of beta & point change when no sudden news > SD of beta & point change when sudden news.

Table 1: Analysis of Moment

No Sudden News		**Beta**	**Point Change**
	N	1371	1371
	Mean	1.200780	21.8384
	Std. Deviation	6.1465754	126.54813
Sudden News		**Beta**	**Point Change**
	N	83	83
	Mean	1.054087	-335.5294
	Std. Deviation	0.0602217	122.52215

Table 2: Hypothesis Assessment Summary

Hypothesis		Mean (Standard Deviation)	Empirical Conclusion
H1: KSE index with no sudden news has more systematic risk.	Beta	1.200780 (6.1465754)	**Accepted**
H2: KSE index with sudden news has more systematic risk.	Beta	1.054087 (0.0602217)	Rejected

6. Discussion and Conclusion

Systematic risks play a vital role in Stock exchange index on daily basis. Because news is the backbone of all indexes and too safe this backbone all the investors buy some sort of shares which have a certain amount of return instead of having loses. However from the findings of this research we came to know that although sudden news plays a vital in role in running a stock exchange and they play a major role in effecting the index and due to sudden news the magnitude of systematic risk and point change become lesser as the investors take less chance to invest while the low magnitude of SD for the outlined constructs in the presence of sudden news reflects that all of the investors more or less follow the same investment trends when market hits with the sudden news.

On the other hand, if there is no sudden news, then there is a different investment pattern of investors in equity market.

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